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Business Outlook Survey

Conducted by the Bank's Regional Offices

Results of the Summer 2010 Survey

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Overview

- The results of the summer survey indicate that the economic recovery is progressing.
- For the first time in two years, firms, on balance, reported an improvement in their past sales activity. While the balances of opinion on future sales growth and investment are lower than in recent surveys, and firms are concerned about global uncertainties, overall, they are positive about the outlook for business activity over the next 12 months.
- While labour shortages remain subdued, capacity pressures have moved up from recent lows. Firms expect input and output prices to increase at a greater rate over the next 12 months, reflecting improved demand conditions and continued recovery from a period of price weakness. Still, inflation expectations remain well anchored within the Bank's inflation-control range.
- On balance, firms reported that credit conditions eased over the past three months.

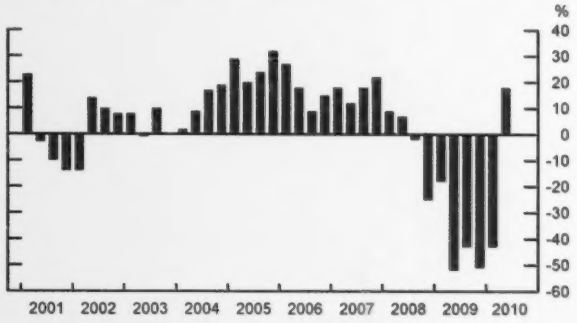
Business Activity

Reflecting strengthening economic conditions, the balance of opinion on past sales growth has turned positive, as more firms reported an improvement in sales growth over the past 12 months than reported a deterioration **(Chart 1)**. The balance of opinion on future sales growth is also positive **(Chart 2)**, indicating that firms expect sales to grow at a greater rate over the next 12 months. Firms expecting a pickup in sales growth are mainly those that still await

Chart 1: Firms report a pickup in sales growth over the past year . . .

Balance of opinion*

Over the past 12 months, did your firm's sales volume increase at a greater, lesser, or the same rate as over the previous 12 months?



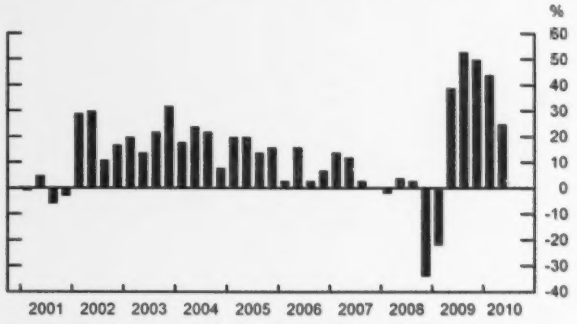
Greater: 49% Same: 21% Lesser: 31%

* Percentage of firms reporting faster growth minus percentage reporting slower growth

Chart 2: . . . and they expect sales volumes to rise at a greater rate over the next 12 months

Balance of opinion*

Over the next 12 months, is your firm's sales volume expected to increase at a greater, lesser, or the same rate as over the past 12 months?



Greater: 53% Same: 18% Lesser: 29%

* Percentage of firms expecting faster growth minus percentage expecting slower growth

The Business Outlook Survey summarizes interviews conducted by the Bank's regional offices with the senior management of about 100 firms selected in accordance with the composition of Canada's gross domestic product. The survey's purpose is to gather the perspectives of these businesses on topics of interest to the Bank of Canada (such as demand and capacity pressures) and their forward-looking views on economic activity. Additional information on the survey and its content is available on the Bank of Canada's website at <www.bankofcanada.ca/en/bos/index.html>. The summer 2010 survey was conducted from 19 May to 15 June 2010. The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding.

The opinions expressed are those of the respondents and do not necessarily reflect the views or policies of the Bank of Canada. The method of sample selection ensures a good cross-section of opinion. Nevertheless, the statistical reliability of the survey is limited, given the small sample size.

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recovery or that saw a modest improvement over the past year. Firms that have experienced a strong recovery, however, generally expect sales growth to slow to a more sustainable pace over the next 12 months. This latter influence explains the lower level of the balance of opinion relative to earlier stages of the recovery. Overall, businesses are generally positive about their near-term sales prospects, although they are concerned about recent global economic and financial uncertainties and possible spillover effects in Canada.

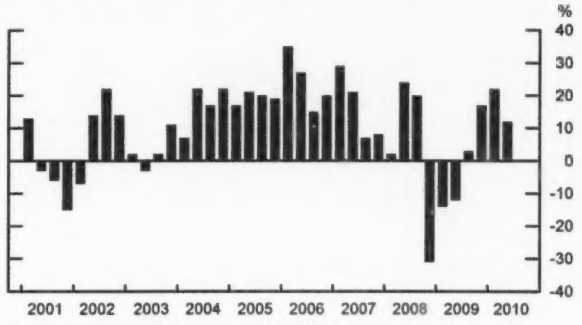
The balance of opinion on investment in machinery and equipment is positive, but has eased from its level in the spring survey **(Chart 3)**. The decline in the balance of opinion is concentrated among firms in the services sector, with a number of firms citing that they had recently completed an investment that would not be repeated over the next 12 months. Intentions to increase spending on machinery and equipment remain solid among businesses in the more capital-intensive goods sector.

As in the previous two surveys, the balance of opinion on employment expectations is at a high level, and indicates that firms expect to increase employment over the next 12 months **(Chart 4)**. This positive sentiment, supported by firms' expectations of improving demand and plans for expansion, is widespread across all regions and most sectors.

Chart 3: Firms expect to increase investment in machinery and equipment

Balance of opinion*

Over the next 12 months, is your firm's investment spending on M&E expected to be higher, lower, or the same as over the past 12 months?



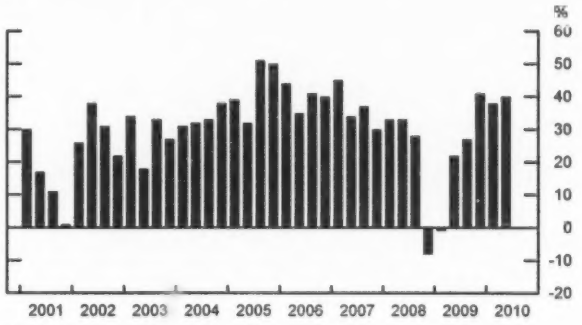
Higher: 38% Same: 37% Lower: 26%

* Percentage of firms expecting greater investment minus the percentage expecting less investment

Chart 4: Firms expect to increase employment

Balance of opinion*

Over the next 12 months, is your firm's level of employment expected to be higher, lower, or the same as over the past 12 months?



Higher: 50% Same: 41% Lower: 10%

* Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

The percentage of firms indicating that they would have difficulty meeting an unexpected increase in demand has moved up from the low levels recorded during the recession and earlier in the recovery **(Chart 5)**. The rise in capacity pressures since the trough in the autumn 2009 survey has been fairly broad-based across sectors and regions, and follows a period during which a number of firms reported having reduced their production capacity because of the recession.

Chart 5: Capacity pressures have moved up . . .

How would you rate the current ability of your firm to meet an unexpected increase in demand?

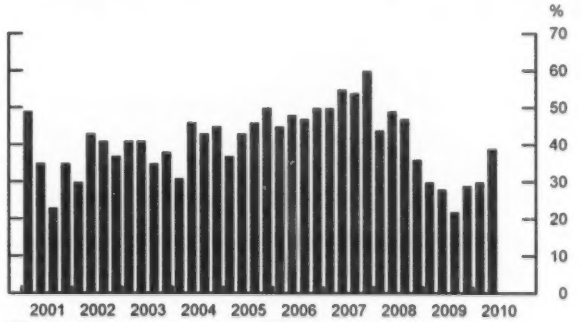
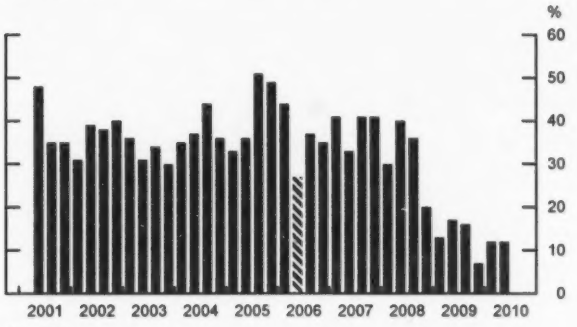


Chart 6: . . . but few firms report labour shortages

Does your firm face any shortages of labour that restrict your ability to meet demand?



Yes: 12%

The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

The percentage of firms reporting that labour shortages are restricting their ability to meet demand is unchanged at a low level **(Chart 6)**. In addition, the majority of firms characterize the intensity of labour shortages as either the same or less intense than at this time last year.

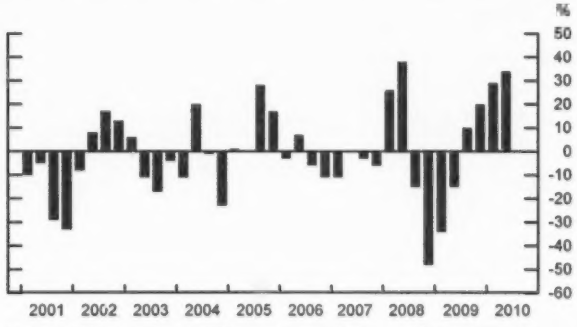
Prices and Inflation

The balance of opinion on input prices is positive and at a high level **(Chart 7)**, indicating that firms expect the prices of inputs to increase at a greater rate over the next 12 months. A number of firms noted that the prices of their inputs were unchanged or had declined over the past 12 months, and that they expect to see prices rise over the next year. Firms often cited expectations of rising prices for commodities and related inputs.

Chart 7: Firms expect input prices to increase at a greater rate . . .

Balance of opinion*

Over the next 12 months, are prices of products/services purchased expected to increase at a greater, lesser, or the same rate as over the past 12 months?



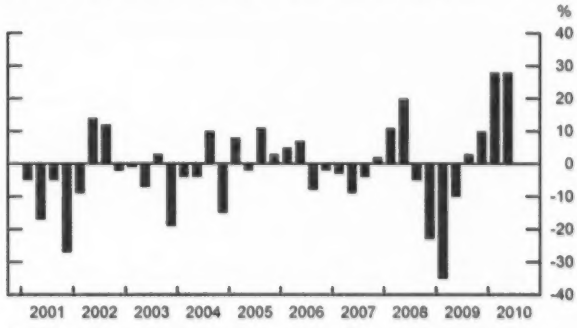
Greater: 48% Same: 38% Lesser: 14% No response: 1%

* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

Chart 8: . . . and output prices to increase at a greater rate as well

Balance of opinion*

Over the next 12 months, are prices of products/services sold expected to increase at a greater, lesser, or the same rate as over the past 12 months?



Greater: 47% Same: 34% Lesser: 19% No response: 1%

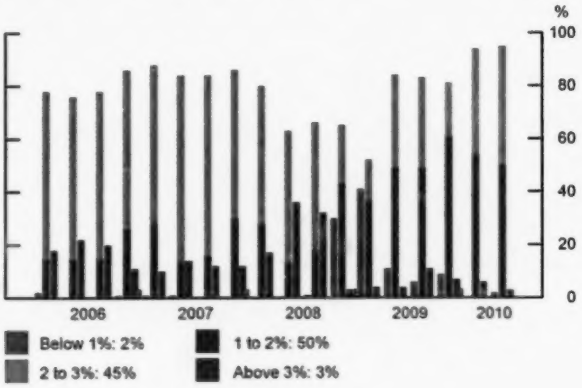
* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

The balance of opinion on output prices also remains strongly positive **(Chart 8)**, indicating that firms expect output prices to rise at a greater rate over the next 12 months. In line with improved demand, many of these firms cited their intention to pass along higher input costs to restore or protect profit margins. The high level of the balance of opinion also reflects, in part, reports from some firms that they intend to keep prices stable or to raise them slightly, after having reduced or frozen prices over the past year.

Expectations regarding total CPI inflation over the next two years remain very well anchored, with nearly all firms anticipating that inflation will be within the Bank's inflation-control range of 1 to 3 per cent **(Chart 9)**.

Chart 9: Inflation expectations remain anchored within the Bank's inflation-control range

Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?



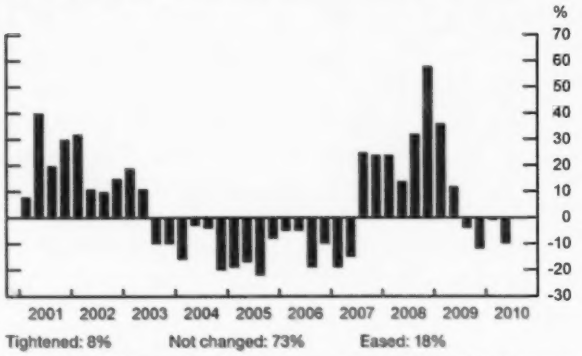
Credit Conditions

The balance of opinion on credit conditions is negative, suggesting that credit conditions eased over the past three months **(Chart 10)**. Although the majority of firms reported no change in credit conditions over this period, those that did report an easing were primarily large firms. For small and medium-sized firms, the results continue to suggest little change in their access to credit, as those firms reporting an improvement in credit conditions were largely offset by those reporting that conditions had tightened. Overall, firms that reported improved credit conditions over the past three months characterized the degree of change as relatively modest.

Chart 10: Credit conditions eased over the past three months

Balance of opinion*

Over the past three months, how have the terms and conditions for obtaining financing changed (compared with the previous three months)?



* Percentage of firms reporting tightened minus percentage reporting eased. For this question, the balance of opinion excludes firms that responded "not applicable."

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